

Material Terms of FIDIC Contracts

by

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Since construction contracts have significant provisions, compared to any other type of contracts, the necessity to provide master agreements, which are internationally accepted and peculiar to different types of construction activities, has arisen. In this regard, the contracts which will be briefly explained below, provided by Federation Internationale des Ingenieurs-Conseils (“**FIDIC**”), are commonly used between parties.

Having based upon the 5th edition of FIDIC contracts which were published in 1999, there are four fundamental contracts, namely (i) Conditions of Contract for Construction (“**Red Book**”), Conditions of Contract for Plant and Design-Build (“**Yellow Book**”), and (iii) Conditions of Contract for EPC / Turnkey Projects (“**Silver Book**”) and (iv) Short Form of Contract.

Firstly, the Red Book is commonly used for building or engineering works. The employer or the engineer as representative of such employer designs the project, and then the contractor will execute the plan. Secondly, the Yellow Book is prevalent for electrical and/or mechanical plant, and for building and engineering works. However, the contractor prepares the project and executes it on the basis of the employer’s expectations. Thirdly, the Silver Book is preferable for the turnkey projects, including power plant, factory or similar facilities or infrastructure projects or similar developments. Such type projects are more certain in terms of the scheduling and cost thus price of such projects are generally pre-determined. Moreover, the contractor will be in charge of the design of the project and its execution. These projects are called EPC since the contractor is responsible for all the Engineering, Procurement and Construction process.

Claims arising out of construction activities can generally be classified in two groups, namely; contractual claims in the contract between the parties, and legal claims which result from the law governing the contract.

Risk between the parties and its consequences:

The unpredictable risk arising from the nature of the construction contracts is considerably higher than the ones arising from other contract types. For instance, unpredictable cost, financial mistakes, tax, change of law or delay caused by third parties, test requirements, necessary consent and permission, default in payment, and currency fluctuation are a couple of crucial risks which may occur during the term of the contract. The parties to the contract agree on all the possible risks, however, it cannot be managed to identify all of them in advance. Since the parties may bear significant liabilities arising out of the contract, FIDIC books generally explain expressly the risk sharing between the parties.

The risk is distributed between the employer and the contractor for the construction work in which the Red and Yellow Book are used, whereas the Silver Book provides that the contractor will bear most of the risk. Risk sharing is of crucial importance that the employer will avoid causing to the additional cost thereby exercising ordinary diligence not to increase the cost. Even though the risk is appeared to be spread between the contractor and employer in the Red and Yellow Book, the former generally bears more risk than the latter.

Furthermore, prior to the signing of the contract, the employer is required to provide a guarantee to the contractor, proving that s/he is able to meet requirements of payments. On the other hand, the constructor must provide a definite guarantee which will be valid until the date the constructor discharges of all its obligations and liabilities.

Contractor's claims:

Clause 20.1 of the Red, Yellow and Silver Books includes the general procedure of the contractor's claims arising out of the contract. These FIDIC books not only provide additional payment for the contractor's claim but also extension of time, which has been introduced for the first time in the 5th edition. However, it should be noted that claims and their consequences may be different and the relevant book for each project should be closely examined. The fundamental claims of contractor (including without limitation) provided by the books can be summarized as follows:

First of all, the contractor may claim extension of time, cost and reasonable profit in the event that;

- (i) the engineer fails to issue an instruction or drawing within a reasonable time, thereby delaying the work, under the Red Book, and also according to the Yellow book, if there are employer's requirements which were not previously discoverable according to sub-clause 1.9 except in the Silver Book,
- (ii) employer fails to give right of access to site within the time stated in the contract under sub-clause 2.1,
- (iii) errors are discovered in original setting-out points and levels of references set out in the sub-clause 4.7. This clause is not included in the Silver Book,
- (iv) the employer delays testing as per the sub-clause 7.4,
- (v) employer delays a test on completion on the basis of sub-clause 10.3,
- (vi) engineer fails to certify or employer fails to pay the amount certified or fails to evidence his financial arrangements, and contractor suspends work according to sub-clause 16.1,
- (vii) works, goods or contractor's documents are damaged by employer's risk as listed in sub-clause 17.3 under sub-clause 17.4,

Secondly, the contractor may claim extension of time and cost in the event that;

- (i) the contractor encounters physical conditions which are unforeseeable under sub-clause 4.12 except in the Silver Book,
- (ii) the contractor deals with an encountered archaeological finding,
- (iii) engineer instructs a suspension of progress according to the sub-clause 8.9,
- (iv) there is a change in the laws of the country upon the sub-clause 7.4,
- (v) Force Majeure, as defined in FIDIC books, prevents the contractor from performing obligations pursuant to the sub-clause 19.4,

Thirdly, the contractor may claim extension of time in the event that;

- (i) the completion set out in sub-clauses 8.2 and 10.1 is or will be delayed under sub-clause 8.4,
- (ii) a country's public authorities cause unforeseeable delay pursuant to sub-clause 8.5.

Fourthly, the contractor may claim cost and reasonable profit in the event that;

- (i) the contractor takes over a part of the works under sub-clause. This clause is not included in the Silver Book,

- (ii) the contractor is instructed to search for cause of a defect for which he is not responsible pursuant to sub-clause 11.8,
- (iii) the employer delays a test after completion and access to the works or plant under sub-clause 12.2 and 12.4 of Yellow Book,

Finally, some important issues with regard to the contractor's claim under any of the FIDIC books, which cannot be classified into the above-mentioned groups, can be explained below:

- The contract price may be adjusted as a result of variations under sub-clause 13.3.
- According to sub-clause 14.8, the contractor may claim also financing changes if the payment is not received in accordance with sub-clause 14.7.
- The contractor may claim losses and damages after terminating the contract under sub-clause 16.4.
- On the basis of sub-clause 17.1, the contractor may claim cost attributable to a matter in consideration for which he is indemnified by the employer.
- If the employer is the insuring party and in fail to affect insurance under sub-clause 18.1, the contractor may claim cost of premium.
- The contractor will be paid for work and other cost after either party gives notice of termination due to the force majeure according to sub-clause 19.6 the contractor may claim cost.
- According to sub-clause 19.7, if the contract becomes impossible or unlawful to perform contractual obligations under the contract, the contractor may be released and can claim payment under sub-clause 19.4. This clause is not included in the Silver Book.

It is very crucial that the monthly progress reports stated under clause 4.21 and 14.3 must be submitted by the contractor to the employer when the payment is requested since delivering of monthly progress reports to the employer is a prerequisite for the payment.

Notifications:

Sub-clause 20.1 indicates the general procedure for claims. The sub-clauses regarding the procedure are same for all the FIDIC books; however, in the Silver Book since the contractor is responsible for all EPC process, the employer will be the one representing his role in the process explained in the Silver Book.

The contractor must give a written notification to the engineer/employer within 28 days after the contractor becomes aware, or should have become aware, of the event which gives rise to the claim. In the event of failure in giving the notice, the contractor will be unable to ask for additional money and extension of time. The contractor should keep a contemporary record to prove his claim if necessary. Furthermore, the contractor must send the detailed claim with the relevant documents within 42 days after the contractor becomes aware, or should have become aware, of the event which gives rise to the claim or within such other period as the engineer/employer may approve. Finally, within 42 days after receiving the claim or detailed claim, the engineer/employer must determine whether the claim is rejected or accepted.

If the contractor fails to comply with the procedure of the contractor's claims, provided that the notice is given, the contractor will be entitled to ask for additional payment and extension of time to the extent that the claim would be mitigated by the damage to the employer arising from the failure to comply with the procedure.

Termination by the employer:

The employer may terminate the contract at any time under clause 15.5, giving notice of such termination to the Contractor. The termination shall take effect 28 days after the later of the dates on which the Contractor receives this notice, provided that the contractor will be paid for the cost of work and its demolition; however, there will be no compensation for the termination. In this regard the employer may expect to be in breach of contract and this provision may be an opportunity for discharging his obligations in advance and avoiding the possible severe consequences of the breach. Hence, the parties must be very careful when the relevant articles of the contract are drafted.

Suspension of the work: The suspension of work is included in sub-clause 16 of the FIDIC books. This clause is very crucial especially in fluctuating market conditions. If the market is not stable, several employers may consider suspending the work until the market starts recovering. The termination of the contract may result in severe consequences including damages and cost. However, after the suspension of the contract, the parties may avoid such consequences if the employer intends to continue the work later on. However, it should be drafted so carefully, that events with no considerable significance should not give entitlement to the employer to suspend the work.

Dispute resolution:

If the construction projects and plans are designed by the contractor, the engineer will be in a position to monitor the process and have authority to settle the dispute between the employer and the contractor.

According to the Red and Yellow books, although the engineer is under an employer's administration, the engineer should make a fair decision under such clauses 3.5, 14.6 and 14.13. On the other hand, under sub-clause 3 of the Silver Book the employer is required to make a fair determination regarding the dispute with the contractor.

The engineer plays vital role in the process of settling the dispute between the employer and the contractor. Moreover, special power regarding dispute resolution is conferred on the engineer by the FIDIC books. Unless otherwise stated in the agreement between the employer and the contractor, the engineer is determined and included in the project by the employer by way of an agreement between himself/herself and the engineer in which the engineer's obligation is set to mediate objectively the disputes between the parties. In other words, the engineer must act not only in the interest of the employer; he must also make balancing decisions.

Each party must comply with the decision given by the engineer or the employer in the Silver book until the decision is revised by the Dispute Adjudication Board ("**DAB**") if one of the parties applies to the DAB under sub-clause 20. The DAB should decide within 84 days or within such other period approved by the parties, starting from the date of the submission of the application. This decision will be valid and binding until it is revised by international arbitration. If the contract is not terminated for any reasons, the contractor will comply with the terms and conditions of the contract.

Provided that the parties agree on the DAB's decision, they should notify each other of their intention within 28 days after the decision. If they are not satisfied with such decision, or if DAB has not given a decision within 84 days, the parties must inform each other of their concern or disagreement, with detailed reasons, within 28 days following such decision or expiration of 84-days period. If the parties fail to inform each other, the decision will be definite and binding. Finally, provided that the decision by the DAB does not become definite, the dispute between the parties may be settled by international arbitration under sub-clause 20.6.